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Magalie Roman Salas, Esq.
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.,
Washington, D.C. 20554

Re: CC Docket No. 80-286

Dear Ms. Salas:

Transmitted herewith, on behalf of TDS Telecommunications Corporation (TDS Telecom or TDS), are an original and 4 copies of its comments in response to the State Members' Report on Comprehensive Review of Separations, CC Docket No. 80-286.

In the event of any questions concerning this matter, please communicate with this office.

Very Truly Yours,

Margot Smiley Humphrey
Margot Smiley Humphrey

Enclosure

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List A B C D E

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Jurisdictional Separations Reform and	)	CC Docket No. 80-286
Referral to the Federal-State Joint Board	)	

COMMENTS OF TDS TELECOMMUNICATIONS CORPORATION

TDS Telecommunications Corporation (TDS Telecom), by its attorneys and on behalf of its 105 incumbent local exchange carriers (ILECs), submits these comments in response to the State Members' Report on Comprehensive Review of Separations.[1]

Introduction and Summary

TDS Telecom agrees that separations are necessary and that changes in regulation and technology are interfering with the previously acceptable results of the existing separations rules. However, instead of the "rolling" freeze recommended by the state members, TDS Telecom urges an immediate freeze of the average separations factors in the 1994-96 period to prevent further unwarranted cost shifts into the state jurisdiction and local rates. In addition, rather than the Report's recommended comprehensive separations review focusing on proposals to assign a substantially greater share of the joint and common costs of providing telecommunications

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[1] Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, CC Docket No. 80-286, State Members Report on Comprehensive Review of Separations (filed Dec. 21, 1998) (Report).

services to the states, TDS Telecom strongly urges that the Joint Board focus on stability, simplicity — a stated Commission goal in this proceeding[2] — and prompt relief from distortions in its separations reforms, so that the Commission, the States and telecommunications providers can devote their attention and resources to a comprehensive and integrated solution for the interwoven issues arising from amendment of the Communications Act.[3]

Separations Procedures Remain Essential to Keeping Regulators Within the Jurisdictional Boundaries of their Authority, But Complex, Burdensome and Expensive Measures Are Unnecessary

TDS Telecom agrees with the Report that the U.S. Constitution continues to make jurisdictional separations necessary. Given the division of regulatory ratemaking responsibility between the interstate and intrastate jurisdictions and the extensive use of the same network to provide services subject to the two regulatory authorities, the Supreme Court responded to a challenge that an intrastate rate order was confiscatory by holding that a decision whether the rates were lawful required "an appropriate determination of the value of the property employed in the intrastate business and of the compensation receivable for the intrastate service under the rate prescribed." Smith v. Illinois Bell Telephone Co., 282 U.S. 133, 149 (1930) (Smith).

Challenges to confiscatory regulation remain possible as long as state and federal regulators set rules and regulations that govern incumbent telephone companies' provision of services and supervise what rates they may charge. Like the State Joint Board members (p. 5), TDS Telecom is not persuaded by arguments that a "forward-looking" cost methodology would

[2] Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Docket 80-286, Notice of Proposed Rulemaking, 12 FCC Rcd 22120 (para.25) (1997).

[3] TDS Telecom addresses the issues in the order of the summary in the Commission's Public Notice, DA 99-414 (rel. Feb. 26, 1999).

make separations unnecessary. Confiscation claims are about what owners have spent and will have to spend to meet their regulatory obligations, not what someone else would have to spend today to serve the same market with a new network. Moreover, there has been little progress in deregulating ILECs, which remain subject to service obligations and at least some level of constraints in both jurisdictions. Even where price cap regulation has been substituted for rate of return regulation, carriers have not been excused from their service obligations and may still object if earnings within the permissible regulatory range prove insufficient to recoup their costs. These carriers have not agreed to forego such claims — e.g., the low end formula adjustment — as part of the transition to the interstate price cap regulatory regime.

The Report is correct, however, that the requirement for separations does not mandate a particular method. The Supreme Court's statement still holds true that, because of "the difficulty in making an exact apportionment of the property . . . extreme nicety is not required" and only "reasonable measures" are "essential."[4] Within this discretionary range, TDS Telecom urges the Joint Board to move towards greater simplicity and reduced distortions, which will comport much better with the emphasis of the 1996 Act on competition, deregulation and universal service.

An immediate interim freeze of the separations factors for rate of return regulated carriers would be a "reasonable measure" that would take into account ongoing changes in the network and federal law, while preserving a jurisdictional division that is consistent with the interim universal service provisions for rural telephone companies. A freeze will also help to retain support for rural ILECs at levels the Commission has indicated are working well and should not

[4] Smith, 282 U.S. at 150 (1930).

change until a satisfactory new universal service mechanism has been developed — and until 2001, at the earliest.[5]

Jurisdictional Separations, Though Unavoidably Arbitrary, Should At Least Serve Statutory Purposes

The Commission and the federal judiciary have long recognized that jurisdictional separations is an inherently arbitrary process, since there is no economic answer to how to divide "interstate" from "intrastate" costs.[6] Thus, separations determinations have properly taken into account public policy implications. Indeed, federal universal service mechanisms have traditionally operated by means of separations procedures designed to prevent excessive costs from falling into the intrastate jurisdiction and, thus, into local rates. In any "reform" of the separations process, careful attention therefore must be paid to policy implications, and the potential for unknowingly altering these past policy decisions.

It is also true, as the Report suggests, that packet switching and changes in the technology and content of communications make it harder to apply the usage-based measurements used in the past to allocate "traffic sensitive" costs between jurisdictions or even to identify what costs are traffic sensitive. The result is that past levels of stability and predictability are increasingly

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[5] See, Joint Board on Universal Service, CC Docket No. 96-45, Order and Order on Reconsideration, para. 8 (rel. July 17, 1998); Address of FCC Chairman William E. Kennard before the National Telephone Cooperative Association, February 10, 1999; Remarks of Commissioner Gloria Tristani before the New Mexico State University Regulatory Issues Conference, March 8, 1999.

[6] MCI Telecomm. Corp. v. FCC, 675 F2d 408, 415-16 (DC Cir 1982) ("The very problem at issue here--allocation of common costs--arises precisely because there is no purely economic method of allocation. In this sense no Commission choice among the various FDC methods could be justified solely on economic criteria; elements of fairness and other noneconomic values inevitably enter the analysis of the choice to be made.")

undermined by using methodologies that produced the right policy result when the underlying facts were different. When costs are accidentally shifted to the states, it also conflicts with the §254(b)(3) universal service mandate to ensure that rural rates are in line with urban rates. The Universal Service Joint Board and the Rural Task Force remain in the early stages of evaluating high cost support mechanisms for rural ILECs. It is essential to provide greater stability and predictability for jurisdictional separations and prevent unintended shifts, so that federal and state regulators can deal with the regulatory costs that must be recovered pursuant to their policies.

Unfortunately, the Commission has contributed to the problems of uncertainty and distortive cost shifts by its recent Internet decision, even though that decision is sound on the question of jurisdiction.[7] The Commission ruled there (¶23) that Internet traffic is "largely interstate," rejecting the "two-call" notion of Internet calling reflected in the Report (paras 10-13). However, for political reasons, the ruling left in place intrastate business line rates and local interconnection arrangements for providing interstate access to information service providers. The Commission's access charge exemption for ISPs has long left carriers confused about how to separate these access costs. Many carriers thought they had no choice but to allocate the costs to the intrastate jurisdiction, though the FCC has never adopted that approach. Although in its recent Internet decision, the FCC said "LECs subject to jurisdictional separations should continue to account for the revenues and costs associated with these connections as intrastate," the Commission does not, and does not have the necessary authority to, increase state rates to account for the increasing costs shifted to the states by such intrastate treatment. Nor do the

[7] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic, CC Docket No., 96-98, FCC 99-38. paras. 16, 20, 23 (rel. Feb. 26, 1999).

states have authority to set rates to recover interstate costs. Moreover, intrastate treatment of interstate costs has already begun to distort the existing separations factors used to allocate costs to the interstate jurisdiction — shifting costs to the states. The Report seems to accept that separations should follow from the tariff used to recover costs. The opposite is true: The purpose of separations is to identify the jurisdiction of costs and services, and the tariffs used to recover the costs should be consistent with the regulatory authority over the traffic. This is the very issue that the Smith case decided, and the decision remains good law.

However, TDS Telecom does not agree that the way to deal with this separations problem is a long term, comprehensive search for more accurate ways to measure the jurisdictional nature of Internet traffic and to gauge usage for packet switches and virtual circuits, as the Report apparently intends (p. 16). It will be difficult, expensive and far from deregulatory to measure the jurisdictional nature of individual Internet calls, which typically go to more than one destination and traverse multiple points on the network. An immediate freeze based on the 1994-96 average separations factors for rural ILECs would reduce the impact of changes in technology on separations results and stem the growing disruption of proper cost recovery, while the issues raised by the telecommunications environment mandated by the 1996 Act are resolved.

<u>Interstate End User Charges Increase the Adverse Effects on Consumers from Unintended Cost Shifts Into the Intrastate Jurisdiction</u>

The Report (pp. 8-9) points to the cost recovery framework which underlay the traditional access and universal service cost recovery calculus — the assumption that local rates would be flat charges and interstate rates would retain their traditional usage-based structure. The Report points out that instituting the SLC as a flat charge for some of the interstate-allocated costs meant that those interstate costs "[f]or all practical purposes ...became part of the basic monthly charge." From this, the Report concludes that the fundamental structure for cost recovery in each jurisdiction has changed, and with it the role of separations in flat rate vs. usage based rate design.

The main reason that this could be viewed as a "problem" for separations, however, is not the one the State members seem to fear — the loss of a tool that clumsily balanced flat against usage-based cost recovery by jurisdictional allocations. Indeed, since both jurisdictions have moved towards a more cost-causative view of what costs are appropriately recovered by flat or usage-based rates, it would seem that the separations process has been freed of excessive rigidity. Moreover, since the inherently arbitrary nature of the state/interstate cost allocation properly brings policy into play, the Joint Board should continue to evaluate separations policies on the basis of results. The relevant change is that, since there are now both state and interstate flat monthly charges to take into account in keeping rates affordable and "reasonably comparable" for rural and urban consumers, the importance of an adequate federal universal service program, funded by nationwide contributions, and the danger that unintended cost shifts into the intrastate jurisdiction will raise local rates are greater than ever.

An immediate freeze to stem the shifts which occur as a result of Internet traffic classification will help prevent further distortions and provide the kind of stability and predictability necessary for comprehensive, result-oriented implementation of the 1996 Act that fulfils the statutory objectives set by Congress. There will be no need to develop burdensome new ways to track and measure usage of packet switched traffic and virtual circuits. Basing the freeze on an average of separations factors from a period at the beginning of the dramatic impact of packet switching and Internet traffic — 1994-96 — would minimize jurisdictional distortions. In contrast, the interim "rolling freeze" the Report proposes would slow, but nevertheless continue, the degradation of reliable and reasonably stable usage-based separations caused by the impact of new technology on traditional usage measurements.

The Allocation of Costs to Comply with Section 254(k) of the 1996 Act and the Coordination of Part 64 and Part 36 Require Coordinated Treatment, But Not By the Separations Joint Board

In effect, Section 254(k) charges states and the Commission with ensuring that carriers do not recover an excessive proportion of the costs under their regulatory authority from captive customers. The Report points out, as Smith holds, that some joint and common costs must be attributed to the interstate jurisdiction to avoid leaving the states with a level of costs that will require them to impose excessive costs on customers of intrastate services and, in particular, on customers of universal services for which cost recovery is within state jurisdiction. The task of determining whether services within a jurisdiction are bearing a fair share of joint and common costs is complicated, however, by the use of federal universal service support mechanisms to recover costs that would otherwise have been intrastate costs. In the past, separations procedures were used as a tool to shift some costs into interstate rates to maintain lower local rates. However, the Commission may also use a federal support mechanism collected from total, unseparated revenues to accomplish the same end. The Commission will have to coordinate its actions to prevent inconsistent access, separations and universal service approaches from undermining the results pursued via each of the interrelated policies.

Section 254(k) also requires state and federal regulators to ensure that the customers of services not faced with competition are not forced to absorb costs that should properly be recovered in the prices charged for competitive services. The Report suggests that current means of separating out unregulated service costs may no longer be adequate.

However, TDS Telecom questions the Report's apparent presumptions that competitive services are equivalent to unregulated services and that universal services are regulated, non-competitive services. That notion prompts the Report's concern over coordinating Parts 36 and 64. The 1996 Act forbids carriers from using noncompetitive services to subsidize competitive services, to be sure, but it also presumes that universal services can and will face competition. Indeed, it requires designation of more than one Eligible Telecommunications Carrier in §214(e) on request in a non-rural ILEC's area and allows additional designations even in rural ILEC areas when consistent with the public interest. That regulators in each jurisdiction must prevent cross-subsidies from non-competitive services and must distinguish both jurisdictional and regulated vs. unregulated costs does not mean that both are jurisdictional separations issues, let alone that both should be resolved in this Joint Board proceeding.

Shifting a Substantially Greater Share of Costs into the Intrastate Jurisdiction Would Undermine the Policies Enacted by the 1996 Act

While stopping short of endorsing a new separations structure, the Report urges consideration (pp. 13-14) of GTE and US West proposals that would shift more costs, revenues and regulatory responsibility to the states. It claims the result would be to tie costs and authority more closely to the jurisdiction with the "the greatest interest in the matter being regulated." The Report does not explain why that benefit would flow from consolidating areas of current dual jurisdiction under sole state authority. The enactment of the 1996 Act and its interpretation by the Supreme Court in AT&T v. Iowa Utilities Board[8] indicate that Congress has asserted a broader federal interest in telecommunications than ever before in the new law. And, while it is

[8] 119 S. Ct. 721 (1999).

true that reducing the incentives for arbitrage between state and interstate charges would be beneficial, there is no reason that the result needs to be achieved by further fragmenting policy making to the state level.

Shifting costs to the states would also undermine the nationwide universal service solution crafted by Congress in §254, saddling more rural states with greater cost recovery responsibilities. Increasing state costs would also add to the challenge of keeping rates "reasonably comparable" in rural and urban areas across the nation and would exacerbate the problems of access charge disparity that make the Act's mandatory geographic interexchange rate averaging harder to achieve. Congress did not adopt the 1996 Act to raise consumer rates.

TDS Telecom also strongly opposes the Report's unexamined surmise (pp.13-14) that any cost shifts not offset by revenue shifts would somehow be rectified by terminating interstate pooling. Cost and risk sharing are even more crucial needs for small and rural ILECs' trying to fulfill their service obligations despite today's increased risks from competition and the uncertainty of extensive regulatory reforms. The Report does not provide any reasons for doing away with nationwide interstate pooling, let alone any explanation of why this fundamental policy tool of interstate access should be swallowed by a proceeding charged with reforming jurisdictional separations.

The state members' valid goals, such as simplifying separations, easing administration and eliminating some usage measurements, which TDS Telecom agrees are well worth pursuing, can be achieved better and at lower overall cost to the system by freezing factors based on the 1994-1996 period, at least for non-price cap carriers. The problem of mismatched allocations and recovery responsibility should be solved. But it can be better and more expeditiously solved by a freeze that prevents ongoing increases due to the allocation of Internet costs to the intrastate jurisdiction. In the future, the Commission and the states can avoid mismatches by simply refraining from leaving costs properly attributed to their jurisdictions for recovery in the other jurisdiction or seeking to regulate recovery of costs that are beyond their authority, as the law requires.[9]

An Interim Freeze Is Appropriate, But Should Not Incorporate a Rolling Average of Separations Factors

The Report proposes (p. 15) an interim separations plan that would freeze separations factors on the basis of a rolling average of the latest three years of separations usage factors on an ongoing basis. The result of this freeze, it says, would be to "dampen[ ] the impact of usage changes and resultant cost shifts from year to year."

As discussed above, freezing separations factors would address many of the criticisms of the existing separations rules, would simplify and add stability and certainty to the cost recovery process, so that other reforms (e.g., universal service, access reform and cost recovery for new requirements such as local number portability and CALEA) could proceed with one less unknown. The freeze would also halt the ongoing hemorrhage of interstate costs into the intrastate jurisdiction and the resulting distortion of the usage factors. Unlike the Report's proposal, using the three year average of factors for 1994-96 would not be limited to slowing down the erroneous results that have debased the accuracy of the separations process in recent years. It would effectively stop the loss of accuracy for both the Internet costs themselves and the other costs driven by the interstate usage factors. Consequently, the true freeze would be superior to the "rolling" freeze in stifling distortions from differences in technology and service

[9] See, Hawaiian Telephone Company v. Public Utilities Commission of Hawaii, 827 F.2d 1264, 1277 (9th Cir. 1987), cert. denied, 487 U.S. 1218 (1988).

offerings, as well as in preventing further shifts of costs into the wrong jurisdiction. The benefits of preventing further damaging distortions that make other issues, such as universal service, more difficult to resolve, far outweigh the minimal benefit that would result from maintaining ongoing usage data, albeit increasingly erroneous data, for monitoring purposes.

Conclusion

For all of the reasons discussed above, TDS Telecom urges the Joint Board and the Commission to move expeditiously to freeze the separations factors at their three-year average for the period from 1994 to 1996. Prompt action will simplify and add stability and accuracy to the separations process and prevent further distortions from new technologies and services. It will also start to remove some of the debilitating regulatory uncertainty plaguing carriers and customers and allow the FCC and carriers time to address the more urgent issues facing the industry, such as universal service, access reform and other 1996 Act implementation issues.

Respectfully submitted,

TDS TELECOMMUNICATIONS CORPORATION

Margot Smiley Humphrey

By: /s/ Margot Smiley Humphrey

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March 30, 1999

CERTIFICATE OF SERVICE

I, Victoria C. Kim, of Koteen & Naftalin, hereby certify that true copies of the foregoing Comments of TDS Telecomm on jurisdictional separations, CC Docket No. 80-286, have been served on the parties listed below, via first class mail, postage prepaid on the 30th day of March 1999.

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